

Office of the State Auditor

Division of State Audit

Department of Corrections and Rehabilitation Bismarck, North Dakota

Audit Report for the
Biennium Ended June 30, 2007
Client Code 530

Robert R. Peterson
State Auditor



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Transmittal Letter

February 15, 2008

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Leann Bertsch, Director, Department of Corrections and Rehabilitation

We are pleased to submit this audit of the Department of Corrections and Rehabilitation for the biennium ended June 30, 2007. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Kevin Scherbenske, CPA. Fred Ehrhardt, CPA, was the audit supervisor. Inquiries or comments relating to this audit may be directed to the audit supervisor by calling (701) 328-3647. We wish to express our appreciation to Director Bertsch and her staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

INTRODUCTION

The North Dakota Department of Corrections and Rehabilitation's mission is to protect the public while providing a safe and humane environment for both adults and juveniles placed in the Department's care and custody. The Department carries out the judgments of the North Dakota courts and provides rehabilitation programs in an effort to successfully reintegrate offenders back into society.

RESPONSES TO LAFRC AUDIT QUESTIONS

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Department of Corrections and Rehabilitation in accordance with generally accepted accounting standards so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Other than our findings addressing the "computer access control weakness" (page 13) and "lack of segregation of duties for inmate account" (page 14), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

The Department of Corrections and Rehabilitation has implemented all recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 20 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Department of Corrections and Rehabilitation's financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), Department of Corrections Subject Tracking and Reporting System (DOCSTARS), and Macola (Roughrider Industries accounting system) are high-risk information technology systems critical to the Department of Corrections and Rehabilitation.

Background Information

The North Dakota Department of Corrections and Rehabilitation is headed by Leann Bertsch, Director, who is appointed by the Governor.

The Department of Corrections and Rehabilitation has three main divisions: Central Office; Adult Services; and Juvenile Services.

Department of Corrections and Rehabilitation includes:

- Central Office.
 - Adult Services.
 - Juvenile Services.
-

Central Office is responsible for the direction and general administrative supervision, guidance, and planning of adult and juvenile correctional facilities and programs within the state.

Adult Services includes the Prisons Division and the Field Services Division.

The Prisons Division is responsible for the care, custody, discipline, training, and treatment of adult persons committed to the state correctional facilities and programs. It includes the State Penitentiary and Missouri River Correctional Center in Bismarck and the James River Correctional Center in Jamestown. Adult Services includes Roughrider Industries, which was established to provide employment to inmates of the State Penitentiary and the James River Correctional Center.

The Field Services Division manages all adult community-placed offenders for the Department, as well as provides administrative support to the North Dakota Parole Board and the North Dakota Pardon Advisory Board.

Juvenile Services includes the Division of Juvenile Services and the Youth Correctional Center. The Division of Juvenile Services is responsible for the community programs and services for juvenile offenders. The Youth Correctional Center is the state's correctional facility for the detention, instruction, and reformation of juveniles who are committed to it according to the law.

The North Dakota Department of Corrections and Rehabilitation's budget for the 2005-2007 biennium totals \$133.5 million. This represents a 14% increase over the 2003-2005 budget. The state general funds comprise \$105 million of the 2005-2007 budget.

The agency regularly reports to the Correctional Facility Review Committee.

Audit Objectives, Scope, And Methodology

Audit Objectives

The objectives of this audit of the Department of Corrections and Rehabilitation for the biennium ended June 30, 2007 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Department of Corrections and Rehabilitation's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Department of Corrections and Rehabilitation and are they in compliance with these laws?
3. Are there areas of the Department of Corrections and Rehabilitation's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Department of Corrections and Rehabilitation for the biennium ended June 30, 2007 was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. To meet the objectives outlined above, we:

Audit Methodology

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's discussion and analysis of the financial statements.
- Performed detailed analytical procedures for expenditures and receipts.
- Tested samples of expenditures, journal vouchers, and correcting entries.
- Reviewed prior year audit workpapers.
- Interviewed appropriate agency personnel.
- Observed Department of Corrections and Rehabilitation's processes and procedures.
- Reviewed North Dakota Century Code chapters 54-23.3, 12-46, 12-47, 12-48, 12-48.1, 12-55.1, 12-59, 27-21, 54-23.4, 2005 and 2007 Session Laws.

Management's Discussion And Analysis

The accompanying financial statements have been prepared to present the Department of Corrections and Rehabilitation's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

The following management discussion and analysis was prepared by Department of Corrections and Rehabilitation's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the biennium ended June 30, 2007, operations of the Department of Corrections and Rehabilitation were primarily supported by appropriations from the state's general fund. This is supplemented by federal funding and fees credited to the agency's operating fund.

FINANCIAL SUMMARY

Revenues consisted primarily of federal funds and Roughrider Industries (RRI) sales, as well as correctional fees collected from individuals on parole (supervision fees).

Federal revenues decreased approximately 15% in fiscal year 2007 compared to fiscal year 2006. This trend is likely to continue as federal funding for correctional programs continues to decrease. Revenue from RRI sales and supervision fees experienced a moderate increase. Supervision fees are expected to continue to increase as long as the number of people under community supervision continues to increase. Revenue from the sale of meals realized a substantial increase from fiscal year 2006. This increase is directly attributable to the cost of providing meals to the North Dakota State Hospital. Transfers in decreased due to the completion of capital projects which are funded with bond proceeds. The proceeds are received from the North Dakota Industrial Commission. The remaining revenue sources remained fairly constant. Total revenues were \$10,881,279 for the year ended June 30, 2007 as compared to \$11,658,575 for the year ended June 30, 2006.

Total expenditures for the Department of Corrections and Rehabilitation were \$63,255,430 for the year ended June 30, 2007 as compared to \$63,563,554 for the prior year.

Salaries and benefits costs increased due to legislatively provided pay increases, increase in health insurance payments, and an increase in authorized positions. Payments made for the purpose of housing inmates outside of the DOCR system (operating fees) increased slightly as the number of inmates placed in the custody of the DOCR continues to increase.

As noted above, total expenditures for fiscal year 2007 were actually \$300,000 less than fiscal year 2006. The decrease in expenditures is attributable to capital projects coming to completion, and to the expiration of federal grant programs. Although total expenditures showed a decrease the cost of incarceration continues to increase. Costs of providing medical services, food, and clothing to inmates experienced a slight increase. Costs of utilities and transportation continue to increase as every year passes.

The increase in expenditures for other repairs reflect the timing of payments. Repairs are held off when possible until the second year of the biennium, when the department is more certain of what it will have available for this cost.

ANALYSIS OF SIGNIFICANT CHANGES IN OPERATIONS

The number of contract community beds were expanded in the 2005–2007 biennium. Assessment and relapse programming accounted for 47 additional beds brought on-line at the Bismarck Transition Center. This programming is targeted at keeping at risk offenders from re-entering the prison. In addition, 25 treatment beds were brought on-line at the North Central Correctional Rehabilitation Center (NCCRC) located in Rugby, ND. The DOCR contracts with NCCRC for the operation of this treatment program.

ANALYSIS OF SIGNIFICANT VARIANCES BETWEEN FINAL BUDGETED AND ACTUAL EXPENDITURES

The Department of Corrections and Rehabilitation ended the 2005–2007 biennium with \$13.9 million of remaining appropriation authority.

\$12.4 million of the remaining amount is other fund authority. The majority of the other fund authority is a result of combination of Roughrider Industries aggressive budgeting and decreasing federal funding. Roughrider Industries employs the philosophy of aggressive budgeting in order to respond to additional sales opportunities when they become available. As to the decrease in federal funding, at the time of 2005–2007 budget preparation, federal funding reductions to correctional grant programs were not anticipated.

\$1.5 million of the remaining amount is unspent general fund authority. For the 2005-07 biennium, the DOCR received a \$4.1 million general fund deficiency appropriation. The deficiency appropriation was mainly attributable to the cost of housing inmates outside of the DOCR system.

Financial Statements

STATEMENT OF REVENUES AND EXPENDITURES

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$2,830,572	\$3,349,703
Roughrider Industries Sales	3,603,981	3,406,458
Correctional Fees	1,368,570	1,217,317
Meal Sales	753,157	506,798
Revenue from Counties	226,057	190,243
Lease Royalties	30,909	56,655
Miscellaneous Revenue	118,692	305,082
Transfers In	1,949,341	2,626,319
Total Revenues and Other Sources	<u>\$10,881,279</u>	<u>\$11,658,575</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$31,095,583	\$29,996,420
Housing – Field Services	6,582,285	5,269,827
Contract Housing - Prisons	4,986,644	6,017,879
Roughrider Industries Expenditures	3,799,326	3,482,931
Medical, Dental, and Optical	3,514,284	3,479,753
Food and Clothing	2,727,864	2,599,314
Grants, Benefits, and Claims	2,171,946	3,082,801
Capital Payments	1,718,359	2,348,348
Utilities	1,438,069	1,420,416
Repairs	816,029	631,629
IT – Data Processing/Equipment/Supplies	789,641	1,188,872
Buildings, Grounds, Vehicle Supply	710,194	650,437
Travel	698,714	777,220
Inmate Wages	365,917	354,922
Rent of Building Space	255,717	240,431
Other Expenditures	1,584,858	2,022,354
Total Expenditures and Other Uses	<u>\$63,255,430</u>	<u>\$63,563,554</u>

STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Capital Assets					
Carryover		\$ 220,301	\$ 220,301	\$ 163,508	\$ 56,793
Equity Pool	\$ 1,500,000	(1,500,000)			
Juvenile					
Community					
Services	7,930,658	316,145	8,246,803	8,044,354	202,449
Field Services	27,075,150	615,610	27,690,760	25,952,077	1,738,683
Prisons Services	79,551,714	4,711,836	84,263,550	79,737,949	4,525,601
Youth					
Correctional					
Center	12,843,309	244,241	13,087,550	12,915,883	171,667
Totals	<u>\$ 128,900,831</u>	<u>\$ 4,608,133</u>	<u>\$ 133,508,964</u>	<u>\$ 126,813,771</u>	<u>\$ 6,695,193</u>
Expenditures by Source:					
General Fund	\$ 101,135,684	\$ 4,091,766	\$ 105,227,450	\$ 103,680,083	\$ 1,547,367
Other Funds	27,765,147	516,367	28,281,514	23,133,688	5,147,826
Totals	<u>\$ 128,900,831</u>	<u>\$ 4,608,133</u>	<u>\$ 133,508,964</u>	<u>\$ 126,813,771</u>	<u>\$ 6,695,193</u>

Appropriation Adjustments:

The \$220,301 capital assets carryover amount was approved by the Capital Construction Carryover Committee.

The \$1,500,000 equity pool adjustment was allocated as follows:

- \$66,145 to Juvenile Community Services.
- \$3,543 to Field Services.
- \$1,254,071 to Prison Services.
- \$176,241 to Youth Correctional Center.

A \$250,000 increase was approved by the Emergency Commission for Juvenile Community Services to accept additional federal funds.

A \$612,067 increase for Field Services and \$3,457,765 increase for Prison Services was deficiency appropriation authority granted by the 2007 legislature in Senate Bill 2023.

A \$68,000 increase was approved by the Emergency Commission for the Youth Correctional Center for a donation received from an individual to purchase the Read Right program.

Expenditures Without Appropriations Of Specific Amounts:

Insurance recoveries has a continuing appropriation authorized by NDCC section 54-44.1-09.1 (\$5,213 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2007, we identified the following areas of the Department of Corrections and Rehabilitation's internal control as being the most important:

Internal Controls Subjected To Testing

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered significant. We concluded internal control was not adequate-noting certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department of Corrections and Rehabilitation's operations or ability to record, process, summarize, and report financial data consistent with the assertions of management in financial statements. Reportable conditions are described below. We also noted other matters involving internal control that we have reported to management of the Department of Corrections and Rehabilitation in a management letter dated February 15, 2008.

Finding 07-1

COMPUTER ACCESS CONTROL WEAKNESS

During our review of the financial information system access controls, it was noted that 6 of 50 former employees tested still had active user ID's. Proper internal controls dictate employee computer access rights be cancelled immediately upon termination. Without this control, it could be possible for former employees to access the state computer system for unauthorized purposes.

Recommendation:

We recommend the Department of Corrections and Rehabilitation:

1. Establish policies and procedures to restrict access privileges to only necessary individuals.
2. Assign ongoing responsibility for security for each information technology application.
3. Perform continuing reviews of access privileges.

Department of Corrections and Rehabilitation Response:

The Department of Corrections and Rehabilitation (DOCR) concurs with this recommendation.

Formal policies and procedures addressing access privileges to computer systems and software applications will be adopted and followed.

LACK OF SEGREGATION OF DUTIES FOR INMATE ACCOUNT

A lack of segregation of duties has created a weakness in the internal control system surrounding inmate accounts. As duties are presently assigned, the individual responsible for maintaining (posting deposits and withdrawals) the individual inmate accounts and calculating inmate payroll (excluding Roughrider Industries) is also responsible for making deposits and for preparing checks for signature. By not properly segregating these duties one individual has access to both cash and accounting records. In addition, although individual accounts are being reconciled to the bank statement and individual account statements are provided to inmates on a monthly basis, we noted that the controlling account has not been reconciled to either the bank account or the individual accounts. This along with the noted lack of segregation of duties results in an increased risk that errors or irregularities in the inmate account may go undetected.

The Department maintains an account at the Bank of North Dakota that includes individual inmate accounts and inmate betterment funds. Individual inmate accounts consist of personal funds typically earned from working within the prison system or received as gifts from family members or friends. The inmate account also holds funds that are to be used for the purpose of inmate betterment. Inmate betterment funds are derived from the operation of inmate activities such as commissary profits, inmate

telephone system commissions and special projects approved of by the Warden. These funds are to be used exclusively for the betterment of inmates either singularly or as a group. Inmate betterment funds can only be used when authorized in writing by the Warden.

Audit Recommendation and
Agency Response

Recommendations:

- 1) The individual who posts activity to the inmate accounts should not have access to cash or the ability to initiate disbursements.
- 2) The individual inmate accounts need to be reconciled to the bank account.

Department of Corrections and Rehabilitation Response:

The Department of Corrections and Rehabilitation (DOCR) concurs with this recommendation.

To improve the internal control surrounding the inmate account duties involving the receipt, disbursement, and recording of cash will either be properly segregated or mitigating procedures will be implemented. Also a complete reconciliation of the control account to the bank statement and the individual accounts will be done on a monthly basis.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2007, we identified and tested Department of Corrections and Rehabilitation's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Legislative Intent Subjected To Testing

- Compliance with appropriation laws (2005 Session Laws).
 - Agency appropriation (chapter 43, sections 1-3).
 - \$44,000 from the field services appropriation line must be used for the Crime Victims Restitution and Gift Fund (chapter 43, section 4).
 - \$135,000 from the youth correctional center appropriation line must be used for capital projects at the youth correctional center (chapter 43, section 5).
 - \$165,000 from the field services appropriation line must be used for interstate transfer or travel of probationers (chapter 43, section 6).
 - \$250,000 from the identified general fund savings may be used for salary equity adjustments for employees in the field services division (chapter 43, section 10).
 - \$515,855 appropriated general funds to be used for the mandatory treatment pilot project (chapter 196, section 5).
 - \$150,000 appropriated general funds for reimbursing a nonprofit, faith-based organization for room and board costs associated with an extended residential care program in northwest North Dakota for indigent adults with substance abuse issues (chapter 27, section 1).
- Collect DNA samples from all inmates for certain offenses for inclusion in the law enforcement data base and collect the costs of the procedure from the person being tested and transfer the amount collected to the Attorney General for deposit into the general fund (NDCC section 31-13-03).
- Collection of a \$40 monthly fee for individuals on probation unless the court determines the imposition of fees will result in undue hardship (NDCC 12.1-32.07).
- The director of the Department of Corrections and Rehabilitation has the duty to accept property forfeited or seized in accordance with the law (NDCC section 54-23.3-04).
- The use of the following legally restricted funds:
 - Penitentiary Land Replacement fund.
 - Crime Victims Gift fund.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.

- Proper use of outside bank accounts, petty cash funds, and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above. However, we noted certain immaterial instances of noncompliance that we have reported to management of the Department of Corrections and Rehabilitation in a management letter dated February 15, 2008.

Operations

This audit did not identify areas of Department of Corrections and Rehabilitation's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

February 15, 2008

Ms. Leann Bertsch, Director
Department of Corrections and Rehabilitation
3100 Railroad Avenue
Bismarck, North Dakota 58501

Dear Ms. Bertsch:

We have performed an audit of the Department of Corrections and Rehabilitation for the biennium ended June 30, 2007, and have issued a report thereon. As part of our audit, we gained an understanding of the Department of Corrections and Rehabilitation's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status as non-reportable conditions.

The following presents our informal recommendations.

LEGISLATIVE INTENT

Informal Recommendation 07-1: We recommend the Department of Corrections and Rehabilitation collect the cost of DNA samples, as required by NDCC 31-13-03, from the individual being tested and transfer the amount to the Attorney General's office for deposit into the general fund.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 07-2: We recommend a non-cardholder review and approve the agency wide P-Card statement.

Informal Recommendation 07-3: We recommend all expenditures be charged to the correct fiscal year.

PAYROLL

Informal Recommendation 07-4: We recommend all Personal Action Forms (PAF) be returned to individuals without payroll access and be properly reconciled to the initiating document. We also recommend the one-time payment query report be run and approved each month by someone independent of payroll preparation.

INVENTORY

Informal Recommendation 07-5: We recommend someone independent of inventory custody review and approve all inventory adjustments.

Informal Recommendation 07-6: We recommend internal controls over the pharmacy inventory be strengthened.

Management of Department of Corrections and Rehabilitation agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

Kevin Scherbenske
Auditor in-charge